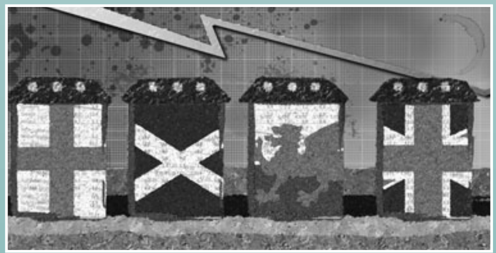
Section 2 Commentary



Chapter 6
Help with housing costs

This year this chapter of the *Review* focuses on two issues, as well as drawing out some key developments from the body of Compendium tables on help with housing costs. The chapter begins by expanding the regular analysis of composition of the main taxes and tax reliefs that apply for private home-owners. It then provides an analysis of the housing subsidy arrangements for council housing, and, in particular, the revenue surpluses now generated in England and Wales.

The net tax position of home-owners

The abolition of mortgage interest tax relief for home-owners in 2000 significantly reduced the long-standing fiscal bias in favour of owning rather than renting, that was one of the factors in the continuing decline of the private rented sector in the UK throughout the twentieth century.

However, there is a continuing, if less pronounced, fiscal bias in favour of home-ownership relative to private renting, as outlined in this chapter in last year's *Review*. The extent of the net favourable tax position for home-owners is set out in Table 2.6.1.

This shows the annual yield from the two taxes that do bear on home-owners – stamp duty and inheritance tax. Both these taxes go rather wider than just home-owners. The stamp duty figures relate to all residential property transactions, while the estimates of the yield from inheritance tax (IHT) are based on the proportion of wealth in residential property held by all individuals subject to IHT, including non-corporate private landlords.

The figures thus tend to overstate the yield that relates exclusively to home-owners. Council tax is not included as this is a tax that applies to households in all tenures, and is thus tenure neutral.

The table also shows estimates of the two primary continuing forms of tax relief enjoyed by home-owners – capital gains tax relief and tax relief on the imputed rental value of the home which the owner occupies. This imputed value was taxed until 1963

Table 2.6.1 **Private owner taxes and tax reliefs**
£ million

	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Taxes														
Inheritance tax	**429**	**440**	**480**	**496**	**611**	**684**	**769**	**870**	**999**	**1,166**	**1,300**	**1,409**	**1,520**	**1,128**
Stamp duty	**465**	**675**	**830**	**1,065**	**1,825**	**2,145**	**2,690**	**3,525**	**3,710**	**4,620**	**4,585**	**6,375**	**6,680**	**2,950**
Gross tax	**894**	**1,115**	**1,310**	**1,561**	**2,436**	**2,829**	**3,459**	**4,395**	**4,709**	**5,786**	**5,885**	**7,784**	**8,200**	**4,078**
Tax reliefs														
Imputed rental return tax relief (net)	**- 7,500**	**- 8,300**	**- 7,400**	**- 9,800**	**- 12,700**	**- 14,000**	**- 14,600**	**- 16,700**	**- 17,300**	**- 14,500**	**- 14,100**	**- 12,600**	**- 9,200**	**- 10,600**
Capital gains tax relief (gross)	**- 500**	**- 600**	**- 800**	**- 1,400**	**- 3,000**	**- 3,300**	**- 6,000**	**- 10,000**	**- 10,500**	**- 13,000**	**- 12,500**	**- 15,800**	**- 14,500**	**- 5,300**
Capital gains tax relief (net)	**- 200**	**- 240**	**- 320**	**- 560**	**- 1,200**	**- 1,320**	**- 2,400**	**- 4,000**	**- 4,200**	**- 5,200**	**- 5,000**	**- 6,320**	**- 5,800**	**- 2,120**
Total tax reliefs	**- 8,000**	**- 8,900**	**- 8,200**	**- 11,200**	**- 15,700**	**- 17,300**	**- 20,600**	**- 26,700**	**- 27,800**	**- 27,500**	**- 26,600**	**- 28,400**	**- 23,700**	**- 15,900**
Net tax position	**- 7,106**	**- 7,785**	**- 6,890**	**- 9,639**	**- 13,264**	**- 14,471**	**- 17,141**	**- 22,305**	**- 23,091**	**- 21,714**	**- 20,715**	**- 20,616**	**- 15,500**	**- 11,822**

Source: Inland Revenue Statistics (various years).
Notes: Estimates of capital gains tax relief are set at 40 per cent of Inland Revenue gross estimates to take account of roll over and taper relief provisions. Capital gains tax reforms begin in 2008/09.
See text in 2007/08 *Review* for details.It should also be noted that the stamp duty and inheritance tax yields are for all residential dwellings, and not just those occupied by home-owners.

(albeit at a very low value), and was the logical counterpart to mortgage interest relief as an offset. This was a parallel to the arrangements for private landlords as the rental value of owners' homes is an income 'in kind' equivalent to the cash income a landlord receives from their tenants.

It would have been logical for mortgage interest tax relief to be abolished at the same time as Schedule A tax, but in was another 37 years before that occurred. While that did reduce the fiscal advantages of home-ownership, it did not remove it, as the absence of Schedule A tax (based on realistic values) has a very substantial net value even after a full allowance is made for mortgage interest against the gross imputed rental values.

The estimates of the net value of Schedule A tax relief show it rising to over £17 billion in 2003/04, before falling back to £10.6 billion. These estimates are based on the asset values and mortgage debt figures from home-owners detailed in Compendium Table 45; average mortgage lender interest rates, net rental yield figures from the IPD UK Residential Investment Index, and standard rates of income tax.

While the methodology for these estimates could be refined, it is robust enough to give a ball park indication of the very substantial value of that relief. However, it should be noted that if such a tax was ever levied it would reduce house prices; and this would in turn reduce the net income from the tax.

Table 2.6.1 also includes figures for the value of capital gains tax relief. The gross figures are those provided by HM Revenues. However, those figures assume that the tax is levied at the full rate, without any provisions for 'taper relief', or the 'roll over relief', which defers the application of the tax when the proceeds from the sale of a home are fully re-invested in another home, which is typically a feature of the tax in those countries, such as Sweden, where the tax is applied to home-owners.

The estimated net values for CGT relief for home-owners shown in Table 2.6.1, take into account the 'taper relief' provisions of the UK CGT regime, and also make provision for roll over relief. The estimates do not, however, make any adjustment for the potential impact of the levying of CGT on house prices.

There are no immediate prospects of any UK government fundamentally reducing the very substantial net tax advantages these reliefs provide for home-owners. This is partly politics, and partly their low visibility – particularly in respect of the tax relief on the 'in kind' benefit of rental values which is an unfamiliar idea outside of economic and taxation theory and history.

But the practical importance of those reliefs do need to be recognised, especially when there are debates about the more visible elements of the tax package for home-owners, or about the respective tax treatment of private landlords. The implications of this fiscal bias for the future prospects of the private rented sector are considered in Commentary Chapter 3.

There is a wide-ranging discussion of housing taxation arrangements, and options for reform, in a newly published Shelter report.[2] This encompasses council tax, stamp duty, capital gains tax and housing tax credits, and goes much wider than the proposal to increase the threshold level for 'rent-a-room' tax relief which has attracted the most media attention.

Housing subsidies for council tenants

The arrangements for council housing subsidies are discussed in Contemporary issues Chapter 3, in the context of the reforms proposed following the CLG HRA review. They have become more controversial in recent years as, in net terms, a national net subsidy has been reversed, so that there is now a net rental surplus from council housing; albeit one that is heavily underpinned by government expenditures on housing benefit (see Compendium Table 114).

The council housing subsidy arrangements also operate differently in England, Scotland and Wales, with a low level of subsidy continuing to be provided in Scotland, while at the national level, net surpluses are now being generated in England and Wales (see Figure 2.6.1 overleaf).

However, there are a number of complex factors underlying these cash surpluses shown in council housing revenue accounts. In particular, the English surpluses in the years before 2001/02 related to years when the Major Repairs Allowances were part of the capital system. When they converted to be part of the subsidy system in 2001/02, the English HRA moved back into net subsidy, and it is only in 2008/09 that it has moved back into surplus.

The continuing, and much higher, levels of surplus in the Welsh HRA arise in part because in Wales Major Repairs Allowances (MRA) continue to be provided as part of the capital finance regime, and thus do not offset the revenue surpluses. If the Welsh Assembly had chosen, as in England, to make MRA provision part of the subsidy system this would have significantly changed the picture. In net terms, there would have been a continuing small positive subsidy until 2007/08, before the HRA moved into a small surplus in 2008/09 (of some £47 per dwelling compared to the £740 per dwelling recorded under the current Welsh HRA regime).

There are no financial arrangements for extracting surpluses from council HRAs in Scotland, and few receive any subsidy other than for hostel schemes. Scottish councils do generate surpluses over and above their baseline annual debt and operating costs, but these are retained within the HRA and are used to directly fund or to support prudential borrowing for investments to improve the housing stock.

More generally, however, the low levels of subsidy and/or surpluses in council HRAs are a consequence of relatively low levels of net investment, and the application of varying proportions of the receipts from council house sales to reduce the levels of outstanding debt. There are also the long-term advantages of having an operating account based on the historic levels of capital debt, rather than current capital values.

In decades gone by when new housing was predominantly provided by councils, rather than housing associations, there was an automatic cross-transfer of value with rent surpluses from older dwellings with low levels of outstanding debt effectively offsetting at least part of the much higher costs of new provision. However, for the last three decades, council housing investment has largely been confined to major repairs and improvements, with new dwellings being provided through housing associations. While some small-scale investment in new council housing is now taking place, the absence of that investment over the last three decades is one of the fundamental reasons why overall debt levels in council HRA accounts are so low, and they now operate either with very limited subsidy or generate surpluses.

The lack of investment in new council housing, together with the debt reductions arising from the application of sales receipts, has opened up a wide gap between historic costs and current values. Thus, despite moving into surplus nationally, the rents of council houses (and housing association dwellings) remain very substantially below current market values. This represents an ‘opportunity cost’ subsidy to social sector tenants – as invisible in its own way as the benefits of Schedule A tax relief for home-owners.

As part of the CLG HRA review, the editor updated an earlier analysis of the value of the economic subsidy to social sector tenants of sub-market rents.[1] The estimated 2007/08 value of those economic subsidies per dwelling for each sector, and for each region of England, are shown in Figure 2.6.2. As can be seen, rents in the Northern and Midland regions of England are much closer to market rents than in London and the Southern regions. This is because while social sector rents in the Southern regions are higher than those in the Midlands and the North,

Figure 2.6.1 **Council Housing Revenue Accounts move from subsidy to surplus in England and Wales**

Source: Compendium Table 109b. Subsidies (+) Surpluses (-).

the differentials are much lower than those for market values.

Taken together, the economic subsidies for the two sectors amounted to some £6.7 billion in 2007/08; a national average of some £36 per week per tenant. These are significant sums; even when set against the somewhat higher levels of explicit subsidy in the form of housing benefit for social sector tenants (Compendium Table 114).

There are likely to be upward central government budgetary pressures on rents in the years ahead, regardless of the outcome of the forthcoming general election. There are many dimensions to the debates around the economic subsidies attached to lifetime social sector tenancies. One dimension those debates should not neglect, however, is the high level of tax reliefs provided to home-owner households. A radical market-orientated policy would logically require very substantial changes for home-owners as well as for social sector tenants.

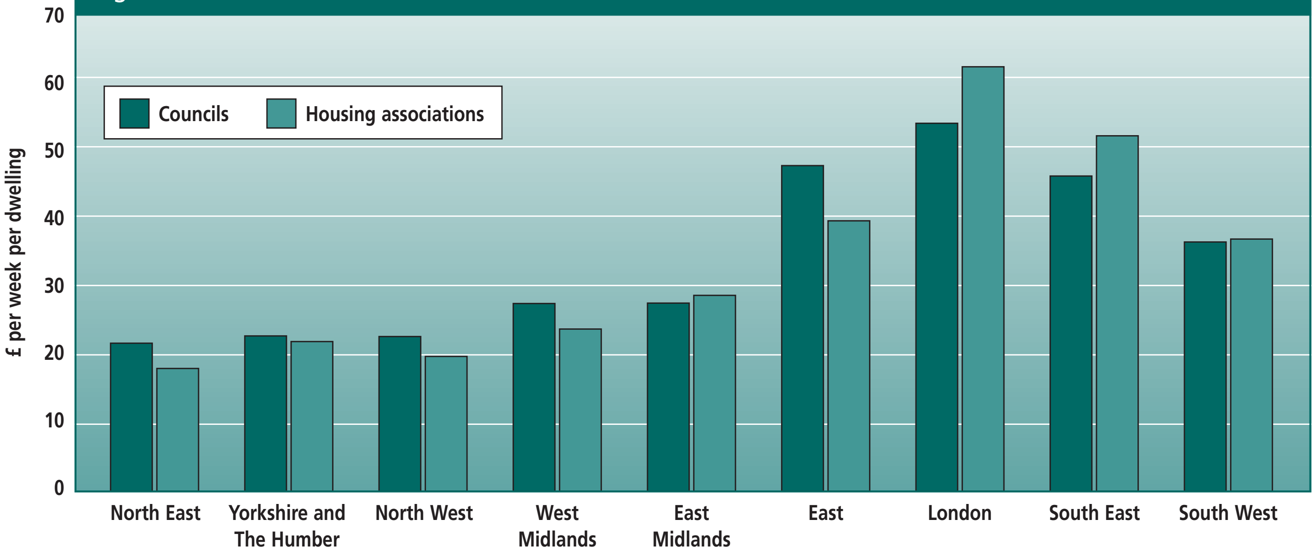
Housing benefit reform

At the time of writing, the government consultation paper on housing benefit reforms promised in the 2009 Budget has yet to emerge. Nor is it clear whether the Budget proposal to limit (from April 2010) the maximum benefit payments to private tenants to the lower of, either the contractual rent, or the level of the Local Housing Allowance (LHA) will actually proceed. Currently tenants can receive up to £15 more than the contractual rent subject to the LHA limit.

This has been the source of some controversy, and does fundamentally undermine the philosophy of consumer choice on which the LHA reforms were predicated. The tenants that would lose out from the new rules are not, however, the most disadvantaged – those eligible for, but not receiving benefit, and those who have not been able to secure accommodation at a rent at, or below, the LHA level remain the most disadvantaged.

More positively, from November 2009 working families no longer have their child benefit taken into account in the calculation of their entitlement to housing and council tax benefits. This represents quite a significant improvement in disposable incomes and work incentives for low-income tenant families.

Figure 2.6.2 **Economic value of sub-market rents for social sector tenants**



Source: Wilcox (2009); figures for 2007/08.

Footnote

1. Wilcox, S. (2009) *Social rents and economic subsidies*, Housing Revenue Account Review Rents and Service Charges Working Paper, Communities and Local Government.
2. Crawshaw, T. (2009) *Rethinking Housing Taxation Options for Reform*, Shelter.

Key Reading

Departmental Report 2009, Department of Work and Pensions, Cm 7594, The Stationery Office, 2009.

Department of Work and Pensions Statistics (website).

Housing Benefit and Council Tax Benefit, Summary Statistics, Quarterly Series, Department of Work and Pensions (website).

Inland Revenue Statistics (website).